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INSIGHTS FROM BDO'S NATURAL RESOURCES PRACTICE

HOW THE GREEN BOOK IMPACTS RENEWABLES AND OIL AND GAS MARKETS

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On May 28, 2021, the Biden administration released its Green Book spelling out the president's revenue and policy proposals. The Green Book touched on a number of issues, including tax credits and incentives for oil and gas and renewable energy.

Overview of the Green Book

The Green Book provides a good sense of what the Biden administration would like to see in future tax legislation. However, what provisions ultimately make it into a bill is yet to be determined. The Green Book proposes to reinstate and increase excise taxes on:

- Domestic crude oil and imported petroleum products.
- Listed hazardous chemicals.
- Imported substances that use one or more of the hazardous chemicals subject to the excise tax as materials in their manufacture or production.

It also:

- Proposes a 15% minimum tax on certain large corporations based on their book income, if in excess of $2 billion, which can be offset or reduced by general business credits.
- Would expand and enhance solar and wind tax credits—including both production tax credits (PTCs) and investment tax credits (ITCs), the carbon oxide sequestration credit and other renewable tax incentives.

Changes to Incentives for Renewable Energy

The Green Book recommends an extension and expansion for several existing clean energy tax incentives as contained in Section 45 and Section 48 for renewable energy facilities that begin construction between 2021 and 2027. The extension would phase out five years after the date on which construction began.

To improve the Section 45Q carbon oxide sequestration credit, the Green Book suggests:

- Pushing forward the credit's commencement of construction deadline by five years (until the end of 2030);
- Overseeing provisions of additional credits of $35 per metric ton of carbon oxide captured from hard-to-abate industrial carbon oxide capture sectors that is disposed of in secure geological storage; and
- For direct air capture products, an additional $70 per metric ton for qualified carbon oxide disposed of in secure geological storage.

In Section 48:

- The investment tax credit would be expanded to include stand-alone storage with a capacity exceeding 5 kWh;
- An additional $10 billion in credits would be authorized for investments in suitable property used in a qualifying advanced energy manufacturing project. This project would be expanded to include more eligible technologies such as energy storage and components, electric grid modernization equipment, carbon oxide sequestration and energy conservation technologies;
- The ITC would increase back up to 30% between 2022 and 2026 (with a 20% annual reduction beginning in 2027) for all qualifying technologies; and
- The ITC expiration date would be extended for certain technologies (i.e., ITCs for geothermal and combined heat and power are set to expire after 2023).

The Green Book also proposes new clean energy incentives, including a credit equaling 30% of a taxpayer's investment in qualifying electric power transmission property placed in service between 2021 and 2032 for overhead, submarine and underground transmission facilities meeting certain criteria.

Additionally, each credit would include a direct pay option, allowing the credit to be treated as equivalent to a payment of tax and refundable if it exceeds taxes otherwise payable. This would ensure that the taxpayer does not need tax capacity to benefit from the credit currently. However, it remains unclear whether the direct pay amount would be equal to the

full amount of the credit otherwise claimable or whether it would be "hair cut" in a way similar to the proposed Growing Renewable Energy and Efficiency Now Act (GREEN Act), H.R. 848. Ideally, if the direct pay amount is "hair cut," the direct payment due would be 85% of the total credit otherwise claimable. Certain developers would be able to forego tax equity investments and instead settle on self-funding or debt financing, including short-term bridge financing secured by the future tax refund and/or long-term project financing. However, should the direct pay option include a "haircut," the more practical choice would be tax equity, especially if the developer cannot otherwise currently utilize depreciation deductions from the project or interest deductions from the debt.

The Green Book also provides that each tax incentive would be paired with "strong labor standards." The proposed GREEN Act includes a labor standards proposal, which may provide a blueprint for what the administration is considering.

Changes to Incentives for Fossil Fuels

The Green Book also proposes rescinding a number of existing incentives available to companies in the fossil fuels industry, which include:

- Fully expensing intangible drilling, exploration and development costs;
- Using percentage depletion with oil and gas wells and hard mineral fossil fuels;
- Introducing credits for costs attributable to duly qualified enhanced oil recovery projects and oil and gas produced from marginal wells;
- Taxation at long-term capital gains rates for any royalties receivable on the disposition of coal or lignite;
- Deducting costs for tertiary injectant which serves as part of a tertiary recovery method;
- Exempting passive loss limitations available for all working interests in oil and natural gas properties;
- Ensuring the availability of strictly two-year amortization of independent producers' geological and geophysical expenditures (increased to seven years);
- Exempting corporate income tax for publicly traded partnerships with qualifying income and gains from activities relating to fossil fuels (effective for taxable years beginning after December 31, 2026);
- Removing tax liability for the Oil Spill Liability Trust Fund excise tax for crude oil derived from bitumen- and kerogen-rich rock; and
- Speeding up the amortization for air pollution control facilities.

Implications for Energy Subsectors

RENEWABLES

The Green Book would advance President Biden's efforts to encourage investment in alternative energy. The new or expanded renewables tax credits and incentives are aimed at accelerating investment interest in the sector and would offset some costs involved with production and transmission facilities, equipment and related labor costs.

The proposals would also advance President Biden's efforts to repatriate energy supply chains. Increasingly, companies have been considering moving operations back to the U.S., especially as the pandemic and other supply chain challenges of the past year uncovered vulnerabilities involved with solely depending on international suppliers.

However, while the proposals are likely intended to accelerate the energy transition, the industry still needs to solve critical limitations to its growth. Most notably, the U.S. isn't a leading producer of solar panels and still imports a majority of supply from abroad. Additionally, electricity storage can't match the affordable and indefinite shelf life of natural gas, which exposes renewable companies to the risk of lost product and revenue streams—in part as a result of the shelf life needed to transport energy.

Among other challenges, companies operating in countries where renewable energy markets are thriving—including France, Germany, Israel and Australia—are looking at the U.S. as a greenfield to expand production and operations outside of their base country. While this leads to increased competition for market share in the U.S., it also spurs concerns for national security as entry points for hackers in the infrastructure and supply chain increase.

BDO TAKE:

The Biden administration's emphasis on renewable energy, combined with the investor community's focus, should prompt an increase in development of renewable energy projects in both the short term and long term. With greater access to capital, it will be more important than ever for renewables companies to execute a strategy for growth and implementation that accounts for the evolving challenges facing the industry.

OIL AND GAS

For oil and gas companies, the Green Book proposals would most likely increase their total tax liability. If the proposals to repeal percentage depletion and immediate expensing of intangible drilling costs are enacted, capital available to oil and gas companies could decrease. To offset this, oil and gas companies should aim to be more efficient in their processes and consider the tax impact of each decision. It's not only about proving that oil exists and selling the leaseholds, but also finding it and operating profitably and efficiently.

Additionally, an inrease in total tax liability could disincentivize some companies—particularly mid-sized players—from drilling new wells or encourage them to decrease production as a means of reducing capital expenditures and mitigating the impact on profitability. If proposals in the Green Book are enacted, oil and gas companies should be mindful of the impact the tax changes can have on operations and prioritize maximizing available capital for financial stability.

BDO TAKE:

Oil and gas companies are generally focused on living within their cash flow and returning capital to their investors. Increased tax burdens would require companies to have a laser focus and study the tax impacts of every operational decision to meet those key goals.

Outlook for an Evolving Landscape

The energy industry will likely see continued efforts from the Biden administration that encourage renewable energy adoption, as well as increased demand from consumers and investors, and companies will need to adapt to the shifts.

In the near term, companies in the renewables space should capitalize on all available tax credits and incentives to compete in an expanding market. Oil and gas companies, meanwhile, may need to prioritize lowering their total tax liability to retain capital needed for operations and new investment.

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